92-1427

Supreme Court, U.S.
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NO. _____

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

INDIANA NATIONAL CORPORATION
AND ITS SUBSIDIARIES: INDIANA
NATIONAL BANK, et al.,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

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QUESTION PRESENTED

Were the Taxpayers' 1970 and 1967 income tax claims for refund timely filed under the plain meaning of 26 U.S.C. Section 6511(d)(1) which contains a special seven year period of limitations applicable to net operating loss carrybacks which involve bad debt deductions?

In other words, is there any language in Section 6511(d)(1) or in the legislative history of Congress that permits the Government to avoid the plain meaning of the statute relied upon by the taxpayers and to interpret Section 6511(d)(1) as requiring that the bad debt deduction be "newly discovered or increased" for the special seven year period of limitations to be applicable?

LIST OF PARTIES

Petitioners:

Indiana National Corporation (NBD Indiana, Inc. by reason of merger October 15, 1992, formerly INB Financial Corporation) and its subsidiaries: Indiana National Bank (INB National Bank), Indiana Realty, Inc., Indiana National Network Corp., Indiana Mortgage Corp. (INB Mortgage Corp.), Consumer Marketing Services, Inc., Tower Agency, Inc. (INB Credit Insurance Agency, Inc.), Indiana National Overseas Corp., TFAC, Indiana National Leasing, Inc. (INB Leasing, Inc.) and Citadel Finance, Inc.

Respondent:

United States of America

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The petitioners, Indiana National Corporation and its subsidiaries Indiana National Bank, et al. ("Taxpayers"), respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit, which affirmed the judgment of the District Court in this case.

OPINIONS BELOW

The opinion of the Seventh Circuit is reported at 980 F.2d 1098 and is reprinted in the Appendix I separately filed herewith at A-1. The opinion of the District Court is reported at 775 F.Supp. 281 and is reprinted in the Appendix II separately filed herewith at A-25.

JURISDICTION

The judgment of the Seventh Circuit was entered on November 30,

1992. The jurisdiction of this Court to review the judgment in question by writ of certiorari is invoked under 28 U.S.C. Section 1254.

STATUTES AND REGULATIONS

Section 6511(d)(1) of the Internal Revenue Code ("Code"), 26 U.S.C. §6511(d)(1) containing the seven year bad debt period of limitations as in effect in 1973 is set forth in full in Appendix X. With respect to Section 6511(d)(1), the pertinent Treasury Regulations Section 301.6511(d)-1(a)(2) is set forth in full in Appendix XIII.

Other provisions of the Code Section 6511(d)(2)(A) and Section 6511(d)(4)(A) cited by the respondent, United States of America, regarding general rules for filing claims for refund involving a net operating loss

("NOL") carryback and an investment tax credit ("ITC") carryback, respectively, in which bad debt deductions are not referred to, are set forth in full in the Appendix XI and Appendix XII respectively.

STATEMENT OF THE CASE

A. Material Facts

The following facts based on the Complaint filed in the District Court (Appendix IV) and on the Affidavit of Charles E. Husman, Vice President and Tax Manager of INC stipulated by the Government for purposes of the Government's motion (Appendix V) are undisputed.

The Taxpayers are affiliated corporations in the banking and lending area that filed consolidated Form 1120 income tax returns with the Internal Revenue Service ("IRS").

The subsidiary Indiana National Bank of Indianapolis timely filed in 1968 its Form 1120 corporate income tax return for 1967 with the IRS. In 1971 the IRS, sent the Indiana National Bank of Indianapolis a 30-day letter containing income tax examination changes for 1967 proposed by a revenue agent which were agreed to including a decrease in its bad debt deductions of $56,690.61. Taxpayers in 1971 timely filed their Form 1120 corporate income tax return for 1970.

Taxpayers in 1974 timely filed their Form 1120, corporate income tax return for 1973, claiming a net operating loss of $4,125,569 and bad debts of $6,038,574 as follows:

	Bad Debts
Indiana National Bank	$5,894,396
Indiana Mortgage Corp.	$103,294
Consumer Marketing Service, Inc.	$35,000

TFAC, Inc.	$2,718
Citadel Finance, Inc.	$3,167

Absent the bad debt deductions claimed of $6,038,574, there would have been no net operating loss for 1973. On December 31, 1974, the Taxpayers filed with the IRS Form 1120X amended return for the calendar year 1973 amending, among other things, a bad debt deduction which was reduced by the amount of $162,218 "to agree with the 1972 Revenue Agents Report in progress."

On September 15, 1977, Taxpayers (having previously on December 31, 1974 filed a Form 1139 Corporation Application for Tentative Refund From Carryback of the Net Operating Loss . . . for 1970 in the amount of $976,764) filed a Form 1120X amended corporate income tax return for the year 1970 carrying back the net operating loss from 1973 per the Form

1120X filed September 15, 1977, in the amount of $4,098,674 from the calendar year 1973 generating the $1,008,274 claim for refund of 1970 corporate income tax.

On September 15, 1977, Taxpayers (having previously on December 31, 1974 filed a Form 1139 Corporate Application for Tentative Refund From Carryback of . . . Unused Investment Credit . . . for 1967 in the amount of $971,297) filed a Form 1120X for the calendar year 1967 showing a recomputation of the tax to reflect an investment credit carryback from 1970 to 1967 as a result of the net operating loss carryback from 1973 to 1970 generating the $862,466 claim for refund of 1967 corporate income tax.

On July 18, 1979, IRS sent Taxpayers a 30-day letter containing

the proposed income tax examination changes covering the Taxpayers' years 1967, 1970, 1973 and 1974. This letter proposed overpayments for 1967, 1970 and 1973 in the respective amounts of $671,761, $802,344 and $20,918, and a deficiency for 1974 in the amount of $92,863. Among the subsidiary changes proposed in the IRS letter were Indiana National Bank decreases in bad debt deduction in the amount of $135,464 for 1973 and increases in bad debt deductions of $10,216 for 1974; Indiana Mortgage Corporation for 1973 and 1974 decreases in bad debt deduction in the respective amounts of $103,294 and $35,945; and T.F.A.C., Inc. for 1974 decreases in bad debt deduction in the amount of $122,183. On November 16, 1979, Taxpayers filed a protest to the July 18, 1979 30-day letter of the IRS

with regard to bad debt deductions of Indiana Mortgage Corporation for 1973 and 1974 in the respective amounts of $103,294 and $35,945 and T.F.A.C., Inc. for 1974 in the amount of $122,183.

Following the filing of Taxpayers' protests for 1967, 1970, 1973, 1974, 1975, 1976, 1977 and 1978, numerous conferences with the IRS Appeals Division were held. On August 10, 1983 Taxpayers' counsel, at the request of the IRS, filed with the IRS a supplemental letter setting forth Taxpayers' position on a statute of limitations question raised by the IRS in 1983 including Taxpayers' reliance on 26 U.S.C. Section 6511(d)(1).

Finally, in 1987, the IRS negotiated a settlement with respect to the issues raised in Taxpayers' protests for 1973, 1974, 1975, 1976,

1977 and 1978. The settlement on Form 906, Closing Agreement on Final Determination Covering Specific Items ("Closing Agreement"), included a provision that the Taxpayers' NOL for 1973 would be $3,807,182. There would have been no 1973 NOL but for bad debt deductions claimed by Taxpayers for 1973 and eventually allowed by the IRS for 1973. The Closing Agreement changes included a decrease in the bad debt deduction of The Indiana National Bank of $135,464 for 1973 and increases in its bad debt deduction for 1974, 1975 and 1976 in the respective amounts of $10,216, $5,406,972 and $4,711,196; a decrease in the bad debt deduction of Indiana Mortgage Corporation of $120,058 for 1976; a decrease in the bad debt deduction of Indiana Acceptance, Inc. for 1975 and 1976 in

the respective amounts of $34,243 and $23,992; and a decrease in the bad debt deduction of INB Mortgage Holding, Inc. for 1976 of $64,387.

B. How the Statute of Limitations Section 6511(d)(1) Question Was First Raised by the IRS in 1983.

Prior to the above July 18, 1979 30-day letter to the Taxpayers from the IRS proposing overpayments for 1967, 1970 and 1973 in the respective amounts of $671,761, $802,344 and $20,918, the Taxpayers' representative met with Revenue Agents and a Group Supervisor and was advised the IRS District Counsel had agreed with the representative's letter on Section 6511(d)(1) dated April 11, 1979 that the 1970 claim for refund filed September 15, 1977 was not barred by the statute of limitations. The IRS at this point in time did not think Section 6511(d)(1) was ambiguous.

In 1983 the IRS Appeals Division Conferee in a settlement conference indicated he had an earlier communication from the IRS District Counsel concluding that the statute of limitations did not bar the 1970 claim for refund which Taxpayers filed September 15, 1977 based on bad debt deductions for 1973 and 1973 net operating loss carrybacks to the calendar 1970. He asked the Taxpayers' representative to review his files with regard to the Taxpayers' position on this statute of limitations question originally considered by the examining revenue agents and group supervisor, by the Taxpayers and ultimately by the IRS District Counsel and comment on the new case of C.E. and C.W. Armstrong v. United States, (Ct. Cl. 1982) 681 F.2d 774 which discussed Section 6511(d)(1)

of the Internal Revenue Code seven year bad debt statute of limitations but which did not cite the previous leading case from the same Court of Appeals, Smith Electric Company, Inc. v. United States, (Ct. Cl. 1972) 461 F.2d 790, which also dealt with the special seven year bad debt statute of limitations. Accordingly, by letter dated August 10, 1983, such comments were sent to the IRS Conferee, this letter was attached to the Taxpayers' refund complaint as Exhibit D and appears in the Appendix IV, pages A-93 to A-130. Prior to 1983 and the 1982 Court of Claims Armstrong decision the Taxpayers and the examining IRS revenue agents, IRS group supervisor and IRS District Counsel in reading the words in Section 6511(d)(1) did not think Section 6511(d)(1) was ambiguous and had all concluded the Taxpayers' 1970 and 1967 income tax

claims for refund were timely filed under the Section 6511(d)(1) special seven-year period of limitation applicable to net operating loss carrybacks which involve bad debt deductions.

C. **Basis for Federal Jurisdiction in Court of First Instance.**

The Taxpayers filed suit in the United States District Court for the Southern District of Indiana, Indianapolis, Indiana ("District Court") for the recovery of federal internal revenue corporate income taxes pursuant to 28 U.S.C. 1346(a)(1). Proper venue lay in the District Court's judicial district which included Indianapolis, Indiana where the Taxpayers principal places of business were located.

REASONS FOR GRANTING THE WRIT

I. **The decision below that the Government by a Revenue Ruling may**

insert the following quoted additional phrase in Section 6511(d)(1) requiring that the bad debt deduction be "newly discovered or increased" for the special seven year bad debt period of limitation to apply, raises an important question which should be settled by this Court as to whether the Government must stick to the plain meaning of the statute relied upon by taxpayers.

This Court has not previously addressed this question of the plain meaning of a statute of limitations, except possibly this Court's recent January 25, 1993 opinion in Bufferd v. Commissioner, _____ U.S. _____, 71 AFTR 2d 93-573 (1993) which referred to the "plain language of §6501(a)". The below Seventh Circuit decision recognized that the question of which Internal Revenue Code provision applied "is a close one", but then changed the plain meaning of the statute.

A. There is no language in Section 6511(d) that affords the Government a right to insert the following quoted additional phrase in Section 6511(d)(1)

requiring that the bad debt deduction be "newly discovered or increased" for the special seven year bad debt period of limitations to apply.

In 1973, the relevant provisions of Section 6511(d)(1) read as follows:

> "(1) Seven year period of limitation with respect to bad debts and worthless securities -- If the claim for credit refund relates to overpayment of tax imposed by subtitle A on account of --
>
> (A) The deductibility by the taxpayer, under § 166 or § 832(c), of a debt as a debt which became worthless, or
>
> (B) the effect that the deductibility of a debt or loss described in subparagraph (A) has on the application to the taxpayer of a carryover, in lieu of the three-year period of limitation . . .; the period shall be seven years from the date prescribed by law for filing the return for the year with respect to which the claim is made. If the claim for credit or refund relates to an overpayment on account of the effect that the deductibility of such a debt or loss has on the application to the taxpayer of a carryback, the period shall be . . . seven years from the date prescribed by law for filing the return for the year of the net operating loss which results in such carryback or the period prescribed in paragraph (2) of this subsection, whichever expires

> the later. In the case of a claim described in this paragraph the amount of the credit or refund may exceed the portion of the tax paid within the period prescribed in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to the deductibility of items described in this paragraph." 26 U.S.C. §6511(d)(1973). (Underlining supplied).

As clearly stated by paragraph (1) and the above underlined language following subparagraphs (A) and (B), the statute applies to carrybacks, if (i) a claim for credit or refund (ii) relates to an overpayment (iii) on account of the effect the deductibility of a bad debt has (iv) on the application to the taxpayer of a carryback, (v) the period of limitation for filing a refund claim with respect to the carryback is extended to the later of two alternative dates. The Taxpayers' claims for refund for 1967

and 1970 are both based on such carrybacks.

The first alternative date is seven years from the Code's deadline for filing the tax return for the year of the net operating loss which generates the carryback (rather than the year to which the carryback is taken). In this case, it is undisputed that seven years from the earliest filing date under the Code for plaintiffs' 1973 return is March 15, 1981. Thus, since the claims for refund Forms 1120X for 1970 and 1967 were filed on September 15, 1977, the Taxpayers' claims for refund based on the carrybacks were filed three and one-half years before the seven year deadline provided in subsection (d)(1) if Section 6511(d)(1) applies in this

case.[1/]

A reading of Section 6511(d)(1) reveals that if the following requirements are met, the seven year period of limitations applies in this case: (i) a claim for credit or refund (i.e., the Taxpayers' 1967 and 1970 claims for refund), (ii) relates to an overpayment (i.e., the Taxpayers' overpayments in 1967 and 1970) (iii) due to the effect of the deductibility of a bad debt (i.e. the effect of the Taxpayers' bad debt deduction for 1973 was to generate the NOL), (iv) has on the application to a taxpayer of a carryback (i.e., the effect of the

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1/ The second alternative is the period prescribed in paragraph (2) of subsection (d). Because a taxpayer must utilize the later to occur of the two alternatives, in this case, the Taxpayers would utilize the first alternative. This Petition therefore addresses the special limitation period on the basis the seven year period deadline applies.

Taxpayers' 1973 NOL attributable to the bad debt deduction is that the NOL may be carried back), then the period of limitations is the longer seven year period.

Throughout the Government's briefs the attempt was made to engraft new additional different words and significant additional requirements onto the provisions of Section 6511(d)(1) and therefore give subsection (d) a wholly different meaning by requiring that the bad debt deduction be newly discovered or later increased. Indeed, the special meaning the Government attempted to impose on Section 6511(d)(1) constituted its entire position with respect to this issue first raised in 1983.

The statute simply was not drafted to support Government's interpretation. The indisputable fact is that absent

the Taxpayers' bad debt deductions for 1973, there would have been no NOL to carry back to 1970 and no ITC to carry back to 1967. It is also unquestionable that the NOL and ITC were available to Taxpayers for carryback.

The effect of the 1973 bad debt deduction, as finally determined,[2/] was to generate NOL and an ITC available for carryback, which carrybacks resulted in claims for refund for the Taxpayer, which like most banks and other lending instituions necessarily

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2/ In its arguments, the Government emphasized the fact that the Taxpayers' 1973 bad debt deduction was adjusted downward several times. Section 6511(d)(1) does not exclude reduced bad debt deductions from its scope. Indeed, as discussed by Taxpayers, the various adjustments to Taxpayers' 1973 bad debt deduction drive home the point that this type of deduction, by its very nature, is subject to adjustment in later years and thus qualifies for a longer period of limitation for filing refund claims--whether or not it actually undergoes adjustment.

over the years will have numerous bad debts. Banks especially by reason of their extensive lending must be given a greater latitude with regard to bad debt adjustments. The above facts are all that Section 6511(d)(1) require for the application of the seven year period of limitations.

B. Section 6511(d)(1) applies because the effect of the Taxpayers' 1973 bad debt deduction was to generate the NOL.

The Government argued that Section 6511(d)(1) only applies in cases where a taxpayer has either (i) taken no bad debt deduction for a taxable year and in a later year discovers a bad debt deduction should have been taken in the earlier year or (ii) taken a bad debt deduction for a taxable year and in a later year discovers that the deduction should be increased. The District Court Opinion agreed with the

Government that Section "6511(d)(1) only applies where the bad debt deduction is newly discovered or increased" and the Seventh Circuit adopted the District Courts interpretation of Section 6511(d)(1).

The lynchpin of the Government's proposed construction of Section 6511(d)(1) was its interpretation of the words "on account of the effect" of a bad debt deduction "on the application to the taxpayer of a carryback." The Government argued that in order for a bad debt deduction to have an effect on the application to a taxpayer of a carryback, the effect can only be caused by a later-discovered or increased bad debt deduction after the return for the year giving rise to the NOL is filed. In the Government's view, it is insufficient that a bad debt deduction either contributes to an

NOL or even generates the entire NOL. The Taxpayers' believe this interpretation is incorrect and contrary to the unambiguous language of the statute, which even the local District Director and District Counsel concluded up until 1983 was not ambiguous and permitted the Taxpayers claimed refunds to be made, but in an amount different than finally agreed upon.

The statute Section 6511(d)(1) clearly states that if a bad debt deduction effects an NOL carryback, then the special seven year period of limitations applies. In this case, the Taxpayers' bad debt deduction for 1973, whether as originally reported, as revised, or as finally determined over 12 years later in the 1987 Closing Agreement certainly had an effect on the Taxpayers' 1973 NOL. Simply put,

without the 1973 bad debt deduction, there would have been absolutely no NOL or ITC carryback by the Taxpayers.

In judging whether one item has an effect on a second item, normally the second item is viewed separately and then in combination with the first item. Thus, if the Taxpayers' NOL is viewed separately without the benefit of the bad debt deduction, the NOL disappears. Surely this effect is sufficient to satisfy the statute. Webster's Seventh New College Dictionary (rev. ed. 1972) defines the noun "effect" as follows: "1: something produced by an agent or cause: . . . "

If the 1973 NOL is judged under this definition, the result of the bad debt deduction is clearly the generation of the NOL. Despite the fact there would have been no 1973 NOL

for the Taxpayers had there been no bad debt deduction, the Government argued that the deduction's "effect" on the NOL "has to mean something more." What greater effect on the NOL could the bad debt deduction have? Whether it was as originally reported, newly discovered, increased or reduced is irrelevant; the fact of the matter is that under any interpretation the 1973 NOL occurred as a direct result of the bad debt deduction for that year.

The Government argued that the effect of the bad debt deduction in this case must be "something more" than an NOL which would not exist but for the bad debt deduction. The Government's argument is explicitly rejected by the statute itself since it requires merely that the result of the bad debt deduction have an effect on

the NOL. In this case, if the Taxpayers' bad debt deduction were removed, no NOL would exist. This is sufficient to satisfy the plain meaning of the statute. As discussed below, in subsection I.C. of this Petition the Regulations promulgated under Section 6511(d)(1) confirm this interpretation.

The plain meaning of Section 6511(d)(1) does not emasculate paragraphs (2) and (4) of subsection (d) as the Government argued. The statute allows taxpayers with bad debt deductions which have an effect on their NOL a longer period of time to file refund claims because bad debt deductions, by their very nature, are subject to change and have been the subject of much dispute and litigation, as the facts leading up to this case demonstrate. It took over 12 years for

the Taxpayers' 1973 bad debt deduction and NOL to be finally determined in the 1987 Closing Agreement. Congress did not take the significant additional step of requiring the bad debt deduction to be later discovered or increased as the Government would require.

The Taxpayers submit there is a substantial difference between the effect on a court of Treasury Regulations prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury and Revenue Rulings that are no more than the opinion of any other lawyer.

C. Sections 6511(d)(2)(a) and (d)(4)(a) relied upon by the Government contain general rules for filing claims for refund involving carrybacks, NOLs and ITCs and nowhere in these statutory paragraphs quoted in the Seventh Circuit Opinion do the words "bad debts" appear nor did Taxpayers rely on those sections.

Section 6511(d)(2)(A), which the Government argues and the Seventh Circuit Opinion concluded is applicable to the Taxpayers' refund claims, contains a special period of limitations with respect to NOL or capital loss carrybacks. Section 6511(d)(4)(A) relates to the period of limitations with respect to ITC carrybacks.

The relevant provisions of Section 6511(d)(2)(A) referred to in the Seventh Circuit Court Opinion read as follows:

"(2) Special period of limitations with respect to net operating loss or capital loss carrybacks. -

> (A) period of limitations. - If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback or a capital loss carryback, in lieu of the 3-year period of limitations prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th

> day of the 40th month (or the 39th month, in the case of a corporation) following the end of the taxable year of the net operating loss . . . which results in such carryback ..." 26 U.S.C. §6511(d)(2)(A) (1973) (as amended by the Tax Reform Act of 1969, Pub. L. No. 91-172. 83 Stat. 487, 696, §512(e)(2)(1969)).

Under Section 6511(d)(2)(A), were it applicable, the Taxpayers' claims for refund for 1970 and 1967 would have been required to be filed on March 15, 1977 rather than September 15, 1977, which was the date the claims were actually filed. Section 6511(d)(4)(A) contained an essentially identical period of limitations with respect to ITC carrybacks. Nowhere in these statutory provisions do the words "bad debt" or the Section under which bad debts are deductible appear. Therefore, the Taxpayers did not and do not rely on those Sections 6511(d)(2) and (d)(4)(A).

D. Methods of calculation and deduction of bad debts have resulted in a history of considerable litigation, both increases and decreases of bad debt deductions of financial institutions, including large bad debt adjustments both increases and decreases for the Taxpayers in the 1970's.

In discussing the provisions of Section 6511(d)(1) it is important to note that Sections 165(g) and 166 cited in Section 6511(d)(1) relate to the deduction for worthless securities and bad debts, respectively. The bad debts deducted by the Taxpayers in 1973 were deducted under Section 166.

Not surprisingly, the determination of whether a debt has become wholly or partially worthless has been the subject of considerable litigation between taxpayers (especially banks, credit, loan and financial institutions such as the

Taxpayers) and the IRS, especially with respect to whether the charge-off of a particular debt was made in the appropriate year. See, e.g., Atlantic Bank & Trust Co. v. Commissioner, 10 BTA 796 (1928); Winder National Bank v. Commissioner, 16 BTA 12 (1929); Southeastern Finance Company v. Commissioner, 4 T.C. 1069 (1945), aff'd. 153 F.2d 205 (5th Cir. 1946); S.W. Coe & Co. v. Dallman, 216 F.2d 566 (7th Cir. 1954); The First National Bank of La Feria v. Commissioner, 24 T.C. 429 (1955), aff'd. 234 F.2d 868 (5th Cir. 1956); Nichols Loan Corporation of Terre Haute v. Commissioner, T.C. Memo 1962-149, rev'd on other grounds, 321 F.2d 905 (7th Cir. 1963) (7th Circuit did not consider the bad debt deduction issue);

and Industrial Credit Co., Inc. v. Commissioner, T.C. Memo 1967-75.

In 1973, under Section 166(c), taxpayers could elect to utilize the "reserve method" for deducting bad debts.

As is the case with taxpayers who utilize the direct charge-off method, the reserve method was the source of a tremendous amount of litigation, especially the issue of whether a taxpayer's additions for a particular year were reasonable. See, e.g., Calavo, Inc. v. C.I.R., 304 F.2d 650 (9th Cir. 1962), rev'g. and rem'g. T.C. Memo 1960-242; and High Plains Agricultural Credit Corp., v. C.I.R., 63 T.C. 118 (1974).

The District Court Opinion and Seventh Circuit Opinion failed to recognize or appreciate the substantial

adjustments (increases and decreases) to the Taxpayers' bad debt deductions as evidenced by:

(a) the Form 1120X for 1973 filed on December 31, 1974 reflecting a $162,218 reduction in the Taxpayers' aggregate bad debt deduction to agree with a 1972 Revenue Agent's Report for that year which was then in progress;

(b) the 30-day letter issued by the IRS with respect to the Taxpayers, which included a $135,464 reduction in the bad debt deduction of The Indiana National Bank for 1973 and an increase in its bad debt deduction of $10,216 for 1974; reductions of $103,294 and $35,945 in the bad debt deduction of Indiana Mortgage Corporation for 1973 and 1974, respectively; and a $123,183 reduction in the bad debt deduction of TFAC for 1974; and

(c) the Form 906, Closing Agreement on Final Determination Covering Specific Matters, executed by the parties in 1987, which included a reduction to the bad debt deduction of The Indiana National Bank of $135,464 for 1973 and increases in its bad debt deduction for 1974, 1975 and 1976 in the respective amounts of $10,216, $5,406,972 and $4,711,196; a reduction in the bad debt deduction of Indiana Mortgage Corporation of $120,058 for 1976; reductions in the bad debt deduction of Indiana Acceptance, Inc. for 1975 and 1976 in the respective amounts of $34,243 and $23,922; and a

reduction in the bad debt deduction of INB Mortgage Holding, Inc. for 1976 of $64,387.

These adjustments to Taxpayers bad debt deduction clearly show the extent to which bad debt deductions are subject to change both as to timing and amount, both increases and decreases.

E. Section 6511(d)(2)(a)(ii) shows Congress did not intend to require bad debt deductions to be newly discovered or increased for Section 6511(d)(1) to apply and Congress is capable of enacting restrictive language to a statute of limitations involving NOL carrybacks where Congress intends such restrictions.

The very position relied upon by Government in its Motion shows that, had Congress intended to include in Section 6511(d)(1) the requirement that the bad debt deduction be newly discovered or increased, it would have done so in plain language. Section 6511(d)(2)(A), which, according to Government applies in this case,

contains the shorter period of limitations applicable to claims for refund attributable to NOLs. Clause (ii) of Section 6511(d)(2)(A), as it read in 1973, provided as follows:

"(ii) with respect to an overpayment attributable to the creation of, or an increase in, a net operating loss carryback as a result of the elimination of excessive profits by a renegotiation (as defined in section 1481(a)(1)(A)), the period shall not expire before September 1, 1959, or the expiration of the twelfth month following the month in which the agreement or order for the elimination of such excessive profits becomes final, whichever is the later." 26 U.S.C. §6511(d)(2)(A)(ii) (1973), (as added to the Code by Pub. L. No. 86-280, §1(a), 73 stat. 563 (1959) and amended by the Trade Expansion Act of 1962, Pub. L. No. 87-794, §317(b), 76 Stat. 872, 1042 (1962). (Underlining supplied).

Section 6511(d)(1)(A)(ii), created a special, longer period of limitations for filing claims for refund where the elimination of excessive profits by renegotiation created an NOL or increased an already existing NOL. In

drafting the special limitation period of Section 6511(d)(2)(A)(ii), Congress insured its provisions would be limited to overpayments of tax attributable to newly created or increased NOLs by explicitly including those words setting forth those requirements in the statute.

The Report of the Senate Finance Committee accompanying the 1959 Act which added Section 6511(d)(2)(A)(ii) to the Code vividly demonstrates that if Congress is concerned that a special limitation period under Section 6511(d)(1) be limited to newly discovered or later increased items, it will insure that specific provisions are included in the legislation:

"The amendments apply only to that portion of the overpayment for any taxable year which is attributable to the creation of, or an increase in, a net operating loss carryback as a result of the elimination of excessive

profits by renegotiation. There will be no extension, by reason of this bill, for any portion of the overpayment which is not so attributable." S.R. No. 663, 86th Cong.. 1st Sess. 622, 623, U.S. Code Cong. & Admin. News 2591, 2592 (1959). (Emphasis supplied).

If Congress had the same concern when it drafted Section 6511(d)(1) as it had when it drafted Section 6511(d)(2)(A)(ii), it would have included similar or identical restrictive language in Section 6511(d)(1). Yet Section 6511(d)(1), the provisions of which are characterized by Government as "careful wording", simply does not require the bad debt deduction to be newly discovered or increased. The District Court Opinion dismissed the logic of this argument of the Taxpayers stating that "If both of these sections were drafted concurrently and related to the same subject, the plaintiffs' argument

might have some force." However it has been held a court may, in interpreting specific language in a statute, consider subsequent Congressional action and later law is entitled to weight when it comes to a problem of construction. Federal Housing Administration v. The Darlington, Inc., 358 U.S. 84, 3 L.Ed 2d.132 (1958). Accord: A. P. Green Export Company v. United States, 284 F.2d 383 (Ct. Cl. 1960).

In the Green case involving Section 109 of the Internal Revenue Code of 1939 the Government cited a single example from the report of the Senate Committee on Finance dealing with a corporation engaged in mining activities in South America. The Court held the effect of the statute should not be severely restricted to the

illustration used in the Committee Report, since it in no way appears that the example was used for that purpose. Further, the Court looked to the later Congress reenactment of the Western Hemisphere trade corporation provisions in Section 921 of the Internal Revenue Code of 1954 indicating that, while subsequent legislation may not be controlling, it may not be disregarded.

The point the Taxpayers are making is that Congress has proven itself quite capable of enacting restrictive language to a statute of limitation involving NOL carrybacks by the use of such words as "creation of" or "an increase in" as shown in the 1959 Act which added Section 6511(d)(2)(A)(ii). Likewise, the single example in a portion of a House Report on Section 332(b)(5) of the Internal Revenue Code

of 1939 to which the District Court Opinion refers where "later evidence" revealed to a taxpayer a debt had previously become worthless, should not be used to severely restrict Section 6511(d)(1), since in no way does it appear that the example was used to insert such words as "creation of" or "an increase in" into the seven year bad debt statute.

F. The basic rules of statutory construction require rejection of the Government's and the lower Court's interpretation of Section 6511(d)(1), since the absence of the specific requirement that the bad debt deductions be newly discovered or increased is evidence this requirement was not intended and courts are not authorized to rewrite a statute and graft upon the statute something not already there.

If Congress had intended Section 6511(d)(1) to require the bad debt deduction be "newly discovered" or "increased", it would have included these requirements in paragraph (1) as

it did when drafting Section 6511(d)(2)(A)(ii). To attempt to engraft such significant requirements simply distorts the statute's unambiguous meaning and is contrary to the well-established principles of statutory construction discussed below. The absence of specific provision is evidence that it is not intended. Central Real Estate Co. v. Commissioner, 47 F.2d 1036 (5th Cir. 1931); Shield Co., Inc. v. Commissioner, 2 T.C. 763 (1943); Wegman's Properties, Inc. v. Commissioner, 78 T.C. 786 (1982). This Court in Bodaracco v. Commissioner, 464 U.S. 386, 398, 78 L.Ed.2d 549 (1984), stated "Courts are not authorized to rewrite a statute because they might deem its effect susceptible of improvements."

It has been held the courts cannot graft upon the statute something not already there. Helvering v. Rebsamen Motors, Inc., 128 F.2d 584 (8th Cir. 1942). According to Panhandle Refining Co. v. Commissioner, 45 BTA 651 (1941), it is the prerogative of a Court to construe the statute, not to add to it. In Smietanka v. First Trust & Savings Bank, 257 U.S. 602, 606, 66 L.Ed. 391 (1922), Justice Brandeis said:

> "But nowhere (in the Act) was words used which can be stretched to include unborn beneficiaries for whom income may be accumulating. It may be that Congress had a general intention to tax all incomes whether for the benefit of persons living or unborn, but a general intention of this kind must be carried into language which can be reasonably construed to effect it. * * * The provisions of such acts are not to be extended by implication.

The basic rule of statutory construction is that the beginning point in any case involving statutory interpretation is the language of the

statute itself and that if the language is plain and unambiguous on its face, it should be given effect. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201-202, 47 L.Ed. 2d 668 (1976); Peare v. McFarland, 778 F.2d 354, 357 (7th Cir. 1985). The most important tool in construing the meaning of a statute levying taxes is the literal meaning of the words employed in the statute, and not the insertion of words such as "newly discovered" or "increased," as the Government suggested in its Briefs and the District Court adopted in its Opinion. United States v. Merriam, 263 U.S. 179, 187-188, 68 L.Ed. 240 (1923). The reference in the District Court's Opinion to the Government's citation of Lehman v. Nakshian, 453 U.S. 156, 69 L.Ed. 2d 548 (1981), for the principle that limitations upon the

United States consent to be sued must be strictly observed is misplaced. The Taxpayers' submit this principle does not authorize the Government or Lower Courts in effect to add new language to the statute.

G. Section 6511(d)(1) and the Treasury Regulations under Section 6511(d)(1) explicitly refute the conclusion of "redundancy" contained in the District Court's opinion by providing a sorting mechanism which limits the utilization of the NOL carryback under Section 6511(d)(1) to that portion of the carryback which pertains to the deductions for bad debts and worthless securities.

In advancing its arguments, the Government fails to cite or even to refer to the Treasury Regulations promulgated under Section 6511(d)(1). It is axiomatic that when interpreting a provision of the Code, the Regulations (not Revenue Rulings such as Revenue Ruling 55-523, 1955 C.B. 497) must be accorded substantial weight. Lykes v. United States, 343

U.S. 118, 127, 96 L.Ed. 791 (1952); Korth v. Mountain City Copper Co., 174 F.2d 295, 297 (10th Cir. 1949). The Regulations provide no basis for the Government's interpretation of Section 6511(d)(1); indeed, they make no reference to a requirement that a taxpayer's bad debt deduction be newly discovered or increased.

What the Regulations do provide, however, is a sorting mechanism which limits the utilization of the NOL carryback under Section 6511(d)(1) to that portion of the carryback which pertains to the deductions for bad debts and worthless securities. In so doing, the Regulations implement the last sentence of Section 6511(d)(1). With respect to the seven year period of limitation applicable to NOL carrybacks under Section 6511(d)(1), the Regulations Section

301.6511(d)-1(a) provide in relevant part as follows:

"(2) If the claim for credit or refund relates to an overpayment on account of the effect that the deductibility of a debt or loss, described in subparagraph (1) of this paragraph [i.e., the deduction for bad debts and worthless securities under Sections 166 and 165(g), respectively], has on the application to the taxpayer of a net operating loss carryback provided in Section 172(b), the period in which claim for credit or refund may be filed shall be whichever of the following two periods expires later;

(i) Seven years from the last date prescribed for filing a return (determined without regard to any extension of time for filing the return) for the taxable year of the net operating loss which results in such carryback, or

(ii) The period which ends with the expiration of the period prescribed in section 6511(c) within which a claim for credit or refund may be filed with respect to the taxable year of the net operating loss which resulted in the carryback." Treas. Reg. §301.6511(d)-1, supra. T.D. 6172, 5-2-56 as amended by T.D. 6425, 11-11-59.

The Regulations make no reference whatsoever to newly discovered or increased bad debt deductions which

surface after the loss year. The sole prerequisite is that the taxpayer have an NOL which is effected by the bad debt deduction for the year and that the NOL may be carried back. Thus, if the taxpayer has a bad debt deduction and an NOL which will result in a carryback as the Taxpayers have in this case, the taxpayer has, at a minimum, seven years from the due date of its return for the taxable year of the NOL resulting in the carryback to file claims for credit or refund which arise due to the carryback.

The Government argues the "unfairness" of an extended period of limitations for refund claims based on an NOL generated in a year in which the taxpayer has both bad debt deductions and other items of deduction. The Government claims it was inappropriate to allow items which would otherwise be

barred from supporting a claim for refund under the provisions of Section 6511(d)(1) to be pulled along by a bad debt deduction and used to offset an overpayment in a prior year. Neither the Code nor the Regulations allow this to occur.

The last sentence of Section 6511(d)(1), as amplified by Section 301.6511(d)-1(a)(3) and (4) of the Regulations, establishes a sorting mechanism pursuant to which taxpayers who have deduction items for a taxable year (but which are barred from being carried back due to the expiration of the period of limitations otherwise applicable to those items) in which they also have bad debt deductions will only be entitled to utilize the seven year period of limitations with respect to the portion of the NOL attributable to the bad debt deduction. The last

sentence of Section 6511(d)(1) provides as follows:

"In the case of a claim described in this paragraph the amount of the credit or refund may exceed the portion of the tax paid within the period prescribed in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to the deductibility of items described in this paragraph. 26 U.S.C. §6511(d)(1)(1973). (Emphasis supplied)

Section 6511(b)(2) otherwise limits the amount of the credit or refund to the amount of tax paid within the general period of limitations provided in Section 6511(a), while Section 6511(c) extends such general period of limitations to six months after the expiration of an agreement between a taxpayer and the IRS to extend the period of time for assessing a tax imposed by Title 26, U.S.C. Section 6511(d)(1) allows a claim for refund filed under its provisions to exceed the tax paid within the periods prescribed in subsection (b)(2) or (c),

whichever is applicable, but only to the extent the refund is attributable to the bad debt or worthless security deduction.

Section 301.6511(d)-1(a)(3) and (4) of the Regulations implements the last sentence of Section 6511(d)(1) and addresses both (i) NOL carrybacks which are attributable to bad debt (and worthless security) deductions and other deduction items which are not barred from carryback and (ii) NOL carrybacks attributable to NOL carrybacks which are attributable to bad debt (and worthless security) deductions and other deduction items which are barred from carryback.

In the case of NOL carrybacks which are based in part on deductions other than bad debts (and worthless securities) which are otherwise barred from carryback by the period of

limitations applicable to those items, the Regulations provide:

"(4) If the claim involves an overpayment based not only on the deductibility of items described in subparagraph (1) of this paragraph [i.e., bad debts and worthless securities] but based also on other items, and if the claim with respect to any items is barred by the expiration of any applicable period of limitations, the portion of the overpayment attributable to the items not so barred shall be determined by treating the allowance of such items as the first adjustment to be made in computing such overpayment." Treas. Reg. §301.6511(d)-1(a)(4), supra. as amended by T.D. 6425, 11-11-59 (Emphasis supplied).

The final two phrases of subparagraph (4) of Section 301.6511(d)-1(a) of the Regulations provide that the portion of the overpayment attributable to the bad debt and worthless security deductions is determined by treating the allowance of the bad debt and worthless security deductions as the first adjustment to

be made in computing the overpayment in the year to which the NOL is carried.

Thus the Taxpayers' carryback of their NOL from 1973 to 1970 must be determined by first stripping away any deductions for 1973 which would be barred from carryback by the period of limitations applicable to NOLs (i.e., all deductions except those relating to bad debts and worthless securities and any other items under Section 6511(d) which enjoy a period of limitations which expired on or after September 15, 1977) and treating the bad debt deduction as the first item to offset the overpayment.

Congress, in drafting Section 6511(d)(1), and the Department of Treasury, in implementing Section 6511(d)(1) through promulgation of the

Regulations, had those situations in mind in which taxpayers with bad debt deductions generating NOLs would have other constituent elements in the NOLs not subject to the special seven year period of limitations. Therefore, to provide an ordering or sorting procedure pursuant to which the bad debt (or worthless security) deduction would be extracted from the NOL, both Congress and the Department of Treasury specified the bad debt (and worthless security) deduction would be determined by treating the allowance of those items as the first adjustment to be made in computing the overpayment for the year to which the NOL is carried.

This ordering and sorting procedure implicit in Section 6511(d)(1) is the reason contrary to the statement of "redundancy" of the District Court's Opinion that this

Court on appeal should find Section 6511(d)(1) is not ambiguous and Section 6511(d)(1) and Section 6511(d)(2)(A) are not redundant as suggested by the following erroneous language in the District Court Opinion:

> Paragraph (d)(2)(A) of Section 6511 provides an extended limitations period for a credit or refund claim which "relates to an overpayment attributable to something more than a net operating loss carry back . . . ." This suggests that to avoid redundancy, paragraph (d)(1) must relate to situations in which the claim is attributable to something more than a net operating loss carryback, thereby supporting the defendant's emphasis, although not ruling out the plaintiffs' interpretation. (Underlining supplied)

Sections 6511(d)(1) and 6511(d)(2)(A) are not ambiguous and are not redundant but cover different situations. Neither is superfluous or a repetition. In the context of Section 6511(d)(1), the Taxpayers' NOL is attributable to the bad debt

deduction. Under the last sentence of Section 6511(d)(1) and Section 301.6511(d)-1(a)(4) of the Regulations, the entire bad debt deduction must be carried back to 1970 to the extent of the amount of the overpayment and resulting refund for that year. This situation of sorting does not occur where there is a NOL and no bad debt deductions involved and the NOL is carried back under Section 6511(d)(2)(A) not under Section 6511(d)(1).

H. The legislative history reveals that Congress did not require bad debts to be newly discovered or increased for Section 6511(d)(1) to apply and the portion of the House report cited by the District Court opinion does not refer to a bad debt later increased or later decreased.

The Government's reliance on a small excerpt from the legislative history is misplaced. Where a statute is plain and unambiguous on its face,

courts will not ordinarily look to legislative history as a guide to its meaning, Ex Parte Collett, 337 U.S. 55, 61, 93 L.Ed. 1207 (1949); Director, Office of Workers' Compensation Programs, U.S. Department of Labor v. Forsyth Energy, Inc., 666 F.2d 1104, 1107 (7th Cir. 1981).

The District Court Opinion noted that the Government in support of its construction of Section 6511(d)(1) cited a portion of a House Report on Section 322(b)(5) of the Internal Revenue Code of 1939, added by the Revenue Act of 1942, ch. 619, 56 Stat. 798 (Appendix VII) which was the forerunner of Section 6511(d)(1) and which provided a seven year limitation period for claims on bad debts. Specifically, the House Report No. 2333 (Appendix VII) in speaking of the seven year bad debt statute of limitations is

entitled "Longer Statute of Limitations For Bad Debts and Worthless Stock Losses."

The District Court Opinion recognized and the Taxpayers several times pointed out that the excerpt does not refer to a situation where a bad debt is later increased or later decreased. See A.P. Green Export Company supra and discussion at page 38 of this Petition that a single example in a Congressional Report is not considered an overall restriction.

II. The decision below is in conflict with the Court of Claims case of Smith Electric Co., Inc. v. United States 461 F.2d (Ct. Cl. 1972) which rejected the same argument by the Government as in this case.

The District Court Opinion indicated there was little case law on the Section 6511(d)(1) issue and mentioned the only such case law being

the two Claims Court cases of Smith Electric Co., Inc., supra, cited by the Taxpayers and Armstrong v. United States, supra, cited by the Government as not controlling. Notwithstanding the District Court Opinion's statement that Smith Electric did not assist the District Court's analysis, the Taxpayers submit that the Taxpayers' position is fully supported by the Court of Claims decision in Smith Electric. The Government's brief in the Smith Electric case was attached as Exhibit K to the Taxpayers' September 28, 1988 Brief to the District Court, is set forth in full in Appendix VI, and indicated that, in support of the enactment of the predecessor of Section 6511(d)(1), the Department of Treasury did not intend the statute to contain the limitations advanced by the

Government. The testimony before Congress of Mr. Randolph Paul, the Tax Advisor to the Secretary of Treasury, with respect to the new seven year period of limitations is particularly illuminating in this regard as set forth in the Government's Brief in the Smith case as follows:

"(c) Statute of limitations on bad debts and worthless stock losses. - The difficulties surrounding the deduction for bad debts and worthless stock losses have long been familiar sources of irritation to taxpayers and the Commissioner alike. It is far from easy to ascertain when a debt is bad or when a share of stock becomes worthless. At the same time, the taxpayer must select the proper year before the statute of limitations has run with respect to that year.

Much litigation is occasioned by the artificial barrier thus thrown up by the statute of limitations, as a taxpayer who chose one year only to be met with the claim that an earlier but barred year was the correct year must battle to defend his choice or lose the deduction entirely.

It is believed that this useless litigation and many of the difficulties in this field can be avoided by, first, eliminating the ascertainment of

worthlessness and the charge-off requirements in the case of bad debts--including securities producing capital losses-and, second, allowing a 7-year statute of limitations with respect to refund claims relating to a deduction on account of these items." House hearings, Committee on Ways and means, 77th Cong., 2d Sess., pp. 92-93; Brief for the United States, Smith Electric Company, Inc. v. United States, No. 474-69, Nov. 2, 1971, pg. 15. (Emphasis supplied).

Surely, if the Treasury Department was concerned that new Section 322(b)(5) should be limited to those situations in which a bad debt deduction is newly discovered or later increased, as the Government argues, the Tax Advisor to the Secretary would have at least mentioned these requirements in his testimony. It is clear that Section 332(b)(5) was enacted in response to the difficulties both taxpayers and the Service encounter in connection with determining the proper year in which a

bad debt should be deducted and that no one was concerned with limiting the scope of the statute to the two situations advanced by the Government in the case at bar.

Despite the Government's argument that the Taxpayers cannot characterize Smith Electric ". . . as dealing with the issue raised here", even a brief analysis of the case reveals the court's decision was based on facts virtually identical to those present here and that the issue was essentially the same as the issue in this case. The taxpayer in Smith Electric properly added $81,943.79 to its bad debt reserve on its return for 1960; the addition was not later increased or challenged by the Service but remained at that amount. Approximately six years later, the taxpayer filed claims

for refund for its taxable years 1957 and 1958 which arose out of an NOL for 1960 attributable to the bad debt deduction. The Service disallowed the claims on the basis they were subject to the same three-year period of limitations contained in Section 6511(d)(2)(A) relied on by the Government in this case. Brief for the United States, Smith Electric, Id. at 11. (Appendix VI).

The Court of Claims quoted the same statute relied upon by Taxpayers in this case and the same excerpt from the House Report on the Revenue Act of 1942 quoted by the Government in its brief and concluded that the taxpayer, who also utilized the reserve method, was entitled to rely on Section 6511(d)(1). Smith Electric, at 793. Id. The Court of Claims concluded that

there was nothing in the period of limitations itself or in the legislative history to indicate the special seven year period contained in Section 6511(d)(1) must be limited to taxpayers who utilize the direct charge-off method. Id. Importantly, the court relied on and even quoted the basic rule of statutory construction that:

> "[T]he plain, obvious and rational meaning of a statute is to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover." Lynch v. Allworth-Stephens Co., 267 U.S. 364, 370, 45 S.Ct. 274, 276, 69 L.Ed. 660 (1925)." Smith Electric, 461 F.2d at 793.

The Court of Claims in Smith Electric rejected the same argument first made by the Government in 1983 in this case that Taxpayers' claims are not allowable on the grounds they were

not filed within the three-year limitation period of Section 6511(d)(2)(A).

CONCLUSION

For all the foregoing reasons, the Taxpayers respectfully request that the Petition for a Writ of Certiorari be granted.

Respectfully submitted,

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